75-3

IN THE

Supreme Court of the United States

OCTOBER TERM 1975

Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

No. 75-3

JAMAICA SAVINGS BANK,

Appellant,

v.

LOUIS J. LEFKOWITZ, as Attorney General of the State of New York

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK

JURISDICTIONAL STATEMENT

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No. 75-

JAMAICA SAVINGS BANK,

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v.

LOUIS J. LEFKOWITZ, as Attorney General of the State of New York

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK

JURISDICTIONAL STATEMENT

Appellant Jamaica Savings Bank (the "Bank") appeals from the judgment of the United States District Court for the Eastern District of New York entered on March 6, 1975, dismissing the Bank's action for injunctive and other relief, and submits this Statement pursuant to this Court's Rules 13(2) and 15 to show that this Court has jurisdiction of the appeal and that a substantial question is presented.

OPINION BELOW

The opinion of the three-judge district court was filed on March 3, 1975, and is reported at 390 F. Supp. 1357. A copy of the opinion is attached hereto as Appendix A, p. 1a.

JURISDICTION

This is an appeal from a final judgment entered by a three-judge district court convened under 28 U.S.C. §§ 2281 and 2284 upon the motion of the Bank, plaintiff below. The action sought, among other relief, a preliminary and permanent injunction to restrain enforcement of a statute of the State of New York on the ground that such enforcement would be in violation of, among others, the Contract Clause, Article 1, Section 10, of the Constitution of the United States (the "Contract Clause").

The final judgment denying all relief was entered, after hearing, on March 6, 1975 (Appendix B, p. 15a). A timely notice of appeal was filed with the Clerk of the United States District Court for the Eastern District of New York on May 2, 1975 (Appendix C, p. 17a). Under 28 U.S.C. § 1253, this Court has jurisdiction to review by direct appeal a judgment entered after hearing denying a permanent injunction in a civil action required to be heard by a three-judge district court. See *Keyishian v. Board of Regents*, 385 U.S. 589 (1967); *Florida Lime & Avocado Growers, Inc. v. Jacobsen*, 362 U.S. 73 (1960); *Palmetto Fire Insurance Co. v. Conn.*, 272 U.S. 295 (1926). The judgment appealed from is such a judgment.

CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

The Contract Clause and Sections 1 and 2 of Chapter 119 of the Laws of 1974 of the State of New York, enacted April 1, 1974 and codified as Section 14-b of the New York Banking Law and Section 5-601 of the New York General Obligations Law ("Chapter 119"), are set out in Appendix D, p. 19a.

QUESTION PRESENTED

Chapter 119 requires New York mortgage lending institutions to pay interest on funds deposited with them by mortgagors to secure payment of real estate taxes and fire insurance premiums. None of the Bank's mortgage contracts provides for the payment of such interest, nor was such interest required to be paid by law in effect before enactment of Chapter 119. The question presented is:

> Whether the above provision, to the extent it would require payment of interest on funds deposited pursuant to mortgage contracts entered into before enactment of Chapter 119, impairs the obligation of such contracts in violation of the Contract Clause.

STATEMENT

The Bank is a mutual savings bank chartered under the laws of the State of New York having its principal place of business in Jamaica, New York. A mutual

savings bank receives funds from depositors and is charged with the duty of investing those funds prudently for the benefit of its depositors. No stockholders participate in earnings or profits of the Bank.

A. Security Deposits under the Bank's Mortgage Contracts.

Approximately seventy percent of the assets of the Bank, amounting to roughly $900 million, are invested in mortgages on one to six family homes in the State of New York. Approximately two-thirds of these mortgages were made pursuant to conventional (non-insured) mortgage contracts. At the time of commencement of this action the Bank was a party to approximately 12,000 conventional mortgage contracts entered into before April 1, 1974 (the date of enactment of Chapter 119) involving loans whose aggregate principal amount was approximately $600 million. These 12,000 conventional mortgage contracts are the contracts at issue in this action.

Each mortgage contract between the Bank and a mortgagor requires the mortgagor to make monthly deposits with the Bank to be held by the Bank as security for the payment of real estate taxes and fire insurance premiums payable by the mortgagor with respect to the mortgaged property. (Such sums will be referred to hereafter as "security deposits".)

The Bank applies security deposits to pay such taxes and insurance premiums as they fall due. Security deposits, which are sometimes referred to as payments into an "escrow account", are designed to protect the Bank against the priority of real estate tax liens in the event of foreclosure, and against uninsured destruction

of some or all of the mortgaged property. Security deposits are a normal feature of almost all mortgages in New York and are required by federal regulation with respect to direct loans by the Veterans Administration and loans insured by the Federal Housing Administration.

At the time this action was commenced, the Bank held approximately $5.2 million of security deposits pursuant to the conventional mortgage contracts it had entered into before the enactment of Chapter 119. It was the policy of the Bank when it entered into these contracts not to pay interest on security deposits, and no law required the Bank to do so. Mortgagors or their attorneys knew of the Bank's policy not to pay interest, and the mortgage contracts were entered into on that basis.

B. The Retroactive New York Statute

On April 1, 1974 the New York legislature enacted Chapter 119. (Appendix D, p. 19a). Sections 1 and 2 of Chapter 119 require that, beginning July 1, 1974, a minimum of two percent interest per annum must be paid on "escrow accounts" maintained in respect of mortgages on one to six family dwellings occupied in whole or in part by the mortgagors thereof. An exception to the requirement of interest payment is provided where a pre-existing mortgage contract expressly disclaims any obligation to pay interest on security deposits made thereunder.

Chapter 119 applies to mortgage contracts whether executed before April 1, 1974 or executed after that date. The security deposits held by the Bank under its pre-existing mortgage contracts fall within the definition

of "escrow accounts" in Chapter 119. Since the Bank's pre-existing mortgage contracts contain no express disclaimer of any obligation to pay interest on security deposits, Chapter 119 requires it to pay the prescribed interest on such deposits.

C. The Proceedings Below

On July 18, 1974, the Bank commenced this action in the court below seeking, among other things, to enjoin the Attorney General of the State of New York from enforcing the provisions of Chapter 119 with respect to security deposits established pursuant to mortgage contracts entered into before April 1, 1974. The Bank alleged that application of the statute to such deposits would violate the Contract Clause. By order dated August 29, 1974, pursuant to the Bank's motion under 28 U.S.C. §§ 2281 and 2284, a three-judge district court was duly convened.

The Bank made a motion for a preliminary injunction and asked that trial on the merits be advanced and consolidated with a hearing on that motion. The Attorney General crossmoved to dismiss the complaint. The parties thereupon entered into a stipulation of facts, and the case was argued and submitted on the basis of that stipulation.

On March 3, 1975, the court, in an opinion by District Judge Mark A. Costantino (Appendix A, p.1a; 390 F. Supp. 1357), denied the Bank's motion for injunctive relief and granted the Attorney General's motion to dismiss. The court held that the Contract Clause was not applicable because (i) no contract right was

impaired by the statute, since no provision in the mortgage contracts gave the Bank the right *not* to pay interest on security deposits, and (ii) even if the statute did impair a contract right, the State had properly exercised its "police power" in doing so.

Judge Whitman Knapp concurred specially, declining to join in the holding that no contract right was impaired, but agreeing that the State had properly exercised police power in adding to the mortgage contracts a new obligation to pay interest.

THE QUESTION IS SUBSTANTIAL

The decision below, upholding a New York statute which clearly has no purpose other than substantive alteration of a contractual relationship between private parties, involves a constitutional question of substantial importance. That question is whether the Contract Clause prevents a state legislature from changing substantive terms of pre-existing contracts between private parties, without any finding that the public order or a vital public interest is involved.

From the earliest history of the Republic the Contract Clause has represented a guarantee to private contracting parties that the states would not alter the substance of their contracts lawfully entered into. See, *e.g.*, *Sturges v. Crowninshield*, 17 U.S. (4. Wheat.) 122 (1819). It was perceived in *The Federalist* (No. 44, James Madison), and continues to be perceived, that protecting the integrity of private contract is an important constitutional objective. This objective touches a valuable freedom that is one of the cornerstones of our social and economic structure. See

El Paso v. Simmons, 379 U.S. 479, 522 (1965) (Mr. Justice Black, dissenting).

The great depression, however, furnished the occasion for unusual and important exercises of state power to preserve the economic order. It was appropriately considered in that context to be essential that state legislatures be permitted to protect the public order and vital public interests, despite the impairment of private contract rights that might result. Accordingly, this Court held that the inherent power of the state to protect the public order necessarily is read into the contract itself, so that an exercise of the protective power cannot constitute an impairment of the contract. The leading case was *Home Building & Loan Ass'n. v. Blaisdell*, 290 U.S. 398, 435 (1934), where this Court said:

> "* * * Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order. The policy of protecting contracts against impairment presupposes the maintenance of a government by virtue of which contractual relations are worth while, – a government which retains adequate authority to secure the peace and good order of society. This principle of harmonizing the constitutional prohibition with the necessary residuum of state power has had progressive recognition in the decisions of this Court."

Following its decision in *Blaisdell*, this Court decided several significant cases where it reiterated and applied the harmonizing principle it had articulated in that case and created, in effect, a body of interpretive decisions

for the guidance of lower courts. See, *e.g.*, *El Paso v. Simmons*, 379 U.S. 479 (1965); *East New York Savings Bank v. Hahn*, 326 U.S. 230 (1945); *Treigle v. Acme Homestead Assoc.*, 297 U.S. 189 (1936); *W. B. Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935).

In the last decade, however, this Court has not had occasion to interpret or apply the Contract Clause. Indeed, there have been only seven cases in which this Court has dealt with the clause since 1945, and only in *El Paso v. Simmons, supra*, was there any extended discussion of the Clause.[1] Without the benefit of current guidance from this Court, some lower courts have been proceeding to interpret the Contract Clause purportedly in pursuance of the *Blaisdell* principle, but actually in clear contradiction of it.[2] The decision

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[1] The other six cases are: *McGee v. International Life Ins. Co.*, 355 U.S. 220, 224 (1957); *Standard Oil Co. v. New Jersey*, 341 U.S. 428, 435 (1951); *Cohen v. Beneficial Ind. Loan Corp.*, 337 U.S. 541, 551 (1949); *Lincoln Federal Labor Union v. Northwestern Iron & Metal Co.*, 335 U.S. 525, 531 (1949); *AFL v. American Sash & Door Co.*, 335 U.S. 538, 539 (1949); *Connecticut Mut. Life Ins. Co., v. Moore*, 333 U.S. 541, 545 (1948).

[2] E.G., *Willys Motors, Inc. v. Northwest Kaiser-Willys, Inc.*, 142 F. Supp. 469 (1956); *Security Unit Employees v. Rockefeller*, 351 N.Y.S. 2d 348 (Sup. Ct. 1974). Other lower courts have applied the *Blaisdell* test correctly. E.G., *Superior Motors Inc. v. Winnebago Industries, Inc.*, 359 F. Supp. 773 (D.S.C. 1973); *State ex rel. Building Owners & Managers Association v. Adamany*, 64 Wis. 2d 280, 219 N.W.2 274 (Sup. Ct. 1974); *Globe Liquor Co. v. Four Roses Distillers Co.*, 281 A.2d 19 (Sup. Ct. Del. 1971), *cert. denied*, 404 U.S. 873 (1972); *Peoples Savings Bank v. County Dollar Corp.*, 43 App. Div. 2d 327, 351 N.Y.S. 2d 157 (2d. Dept. 1974), aff'd 35 NY2d. 836, 362 N.Y.S. 2d 864 (1974).

below is a particularly harsh example of current misapplication by lower courts of the *Blaisdell* harmonizing principle.

In upholding Chapter 119, the court below expressly permitted the New York State legislature to impair the obligation of a contract by reason of a purported exercise of "police power". However, the purported exercise of police power was merely "to correct an imbalance in the bargaining relationship" (Appendix A, p. 10a, 390 F. Supp. at 1362), the consequence of which was to award to mortgagors an average amount of less than nine dollars per year that otherwise would have remained in the hands of mortgage lending institutions.

It is not asserted, nor could it properly be asserted, that the public order was threatened or that any vital public interest was involved in choosing the recipient of less than nine dollars per year. It is clear that Chapter 119 simply expresses a legislative preference as to which of two private contracting parties should have that small sum of money.

This is the sort of legislative preference that may be permissible when prospectively enforced, but is impermissible when applied to existing contracts. The constitutional distinction between prospective and retrospective application of a statute is well drawn in *Sturges v. Crowninshield, supra*, where this Court said (17 U.S. (4 Wheat.) at 207):

> "If the law be, that no person shall take more than six per centum per annum for the use of money, and that, if more be reserved, the contract shall be void, a contract made thereafter, reserving seven per cent., would have no obligation in its commencement; but if a law should declare that contracts already entered into, and reserving the

> legal interest, should be usurious and void, either in the whole or in part, it would impair the obligation of the contract, and would be clearly unconstitutional."

A prospective statute regulating private contracts may enforce a mere legislative preference and is held constitutionally only to a standard of rationality. But when a statute impinges retrospectively upon a pre-existing contract right the statutory purpose may not be merely enforcement of a legislative preference. The statutory purpose must be a deeper one grounded upon the power to preserve the public order or to protect a vital public interest, since it is only these "essential attributes" of state sovereignty that are read into existing contracts. See *Blaisdell, supra.*, 290 U.S. at 435. In *Blaisdell,* this Court said (290 U.S. at 439):

> "Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. *The reserved power cannot be construed so as to destroy the limitation,* nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other. * * *" (emphasis supplied).

The court below has construed the reserved power "so as to destroy the limitation".

It is not necessary to resort to conjecture to know that the New York State legislature did not even purport to act in protection of a vital public interest when it passed Chapter 119.

Four public memoranda – one prepared by sponsors of a similar bill proposed by the Attorney General of the State of New York; one prepared by Senator

McGowan, Chairman of the Senate Standing Committee on Banks and sponsor of Chapter 119; one prepared by the New York State Banking Department; and one prepared by the Governor – speak on the legislative purpose of Chapter 119. The legislative purpose expressed by these memoranda is summarized by the following assertion of Senator McGowan: "The point, however, is that a bill requiring some interest to be paid appears to be equitable to bank customers and of little burden to the banks." There is no finding or assertion in any of the memoranda that any other interest of the state was involved.

The lack of any legislative purpose to protect a vital public interest is also manifest on the very face of Chapter 119. Chapter 119 expressly excepts from its application pre-existing mortgage contracts which contained a specific disclaimer of any obligation to pay interest on security deposits. If the statute were an exercise of police power deemed so essential to subserve a vital public interest as to justify impairment of an *implied* contractual right not to pay interest, it would equally justify impairment of an *express* contractual right not to pay interest. From the standpoint of the public interest there would be no appropriate distinction between an implied and an express contractual right. The fact that the statute leaves inviolate an express contractual right not to pay interest constitutes a legislative admission that a vital public interest is not involved.

It is clear that the present statute, since it does not act upon a vital public interest, simply expresses a legislative desire to correct what it perceives to be a bargaining imbalance between two sets of private

contracting parties. In this circumstance, the New York legislature has not approached compliance with the *Blaisdell* principle, and the court below has not applied the principle in the manner mandated by decisions of this Court. Indeed, the court below has done just what Chief Justice Hughes warned against in *Blaisdell*. It has permitted the exception to swallow the rule. The practical result of the decision below is to read the Contract Clause out of the Constitution.

The full potential impact of the decision below upon the Contract Clause can best be measured in the context of an analysis of the decision itself.

The decision was grounded on (i) the absence of an obligation of contract regarding payment of interest that could be impaired, and (ii) the propriety of the exercise of police power to impair such an obligation if it did exist.

1. *Impairment of a Contractual Obligation.* The court below rested its conclusion, with which Judge Knapp disagreed, that there was no contract to be impaired upon (a) the absence of an express provision in the mortgage contracts that interest on "escrow accounts" was *not* to be paid, and (b) on the absence of New York law clearly providing that "interest is not payable on escrow funds." (Appendix A, p. 8a; 390 F. Supp. at 1361). Of course the Bank does not contend that the mortgage contracts contained an express provision that interest would not be paid on security deposits. Had there been such a provision the case would not be here; the exception to Chapter 119 would have been applicable and no payment of interest would have been required under Chapter 119. By the same token, however, it was neither contended nor held

below that either the mortgage contract or the applicable law prior to enactment of Chapter 119 provided *for* payment of interest on security deposits. The court below merely failed to find a declaration of law satisfactory to the court to the effect that interest was *not* to be paid.

Of course, the existence of a contract right that was impaired by the statute is a critical premise of the Bank's position here. However, this Court's decisions applying the Contract Clause recognize that (1) the laws of the applicable jurisdiction (here New York) at the time of the making of the contract form an integral part of the "obligation" of the contract (*W.B. Worthen Co. v. Kavanaugh, supra,* at 60; *Home Building & Loan Ass'n. v. Blaisdell, supra,* at 429-30; *Sturges v. Crowninshield, supra,* at 197), and (2) the Clause is violated not only when an explicit contract right is deleted, but also when a new obligation is added. See *Green v. Biddle,* 21 U.S. (8 Wheat.) 1, 84 (1823); *Ogden v. Saunders,* 25 U.S. (12 Wheat.) 213, 256-57 (1827).[3] It is therefore irrelevant whether or not the mortgage contracts contained an express disclaimer of an obligation on the part of the Bank to pay interest, or simply failed to contain any such obligation. If the law at the time of making of the contract did not

[3] In *Ogden v. Saunders, supra,* at 256, the court said:

"A contract is defined by all to be an agreement to do, or not to do, some particular act; and in the construction of this agreement, depending essentially upon the will of the parties between whom it is formed, we seek for their intention with a view to fulfil [sic] it. Any law, then, which enlarges, abridges, or in any manner changes this intention when it is discovered, necessarily impairs the contract itself which is but the evidence of that intention."

require payment of interest, later legislative imposition of an obligation to pay interest would impinge upon an existing contract right.

When we look to the law of New York at the time the mortgage contracts were made we find indisputably that no such requirement to pay interest was imposed. See *Surrey Strathmore Corp. v. Dollar Savings Bank,* 36 N.Y.2d 173 (1975)[4]; *New York State Thruway Authority v. Hurd,* 25 N.Y.2d 150 (1960); *Tierney v. Whitestone Savings and Loan Ass'n.,* Cal. No. 105Q (App. Term, Sup. Ct., N.Y., 1975) *rev'g.* 353 N.Y.S. 2d. 104; *Ball v. Jamaica Savings Bank,* No. 3397/72 (Sup. Ct., N.Y., 1974). All of these cases hold that no interest obligation is imposed by law, and *no* New York case holds that it is. Indeed, Chapter 119 was enacted for the very reason that no interest obligation was imposed by New York law in the absence of the new legislation. See *Surrey Strathmore Corp. v. Dollar Savings Bank, supra,* at 178.

The majority below erred by turning the question around, saying (Appendix A, p. 9a; 390 F. Supp. at 1361):

> "* * * It is enough for us to say that New York law falls short of declaring as a term of the mortgage, that interest need not be paid on such funds."

Judge Knapp, in his separate concurring opinion, recognized that the majority was asking the wrong

[4] It may be noted that in the *Surrey Strathmore* case, the New York Court of Appeals expressly disclaimed applicability of that decision to the issues raised herein. 36 N.Y.2d at 178, note 2.

question. He aptly observed (Appendix A, p. 14a; 390 F. Supp. at 1364):

> "* * * [T]he mortgage contracts between the homeowners and the banks *necessarily comprehend* the entire understanding between the parties – which must include the *payment or non-payment* of interest * * *." (emphasis supplied).

The reason for Judge Knapp's separate opinion was that, given the clear necessity that the mortgage contract provide either for "payment or non-payment" of interest, they must be said to have provided for "non-payment of interest", since neither the mortgage contracts nor the applicable law at the time of their making provided for the *payment* of interest. The absence of a requirement to pay interest was a term or obligation of the contracts. Thus, enactment of a statute purportedly inserting into the mortgage contracts an obligation to pay interest undeniably constituted a substantial alteration of the contractual relationship between the parties.

2. *Police Power*. All three judges below concurred in the holding that, "even if" it was sufficiently provided by contract that no interest on security deposits was to be paid,

> "the state legislature would have had the right under its police power to require that mortgage lending institutions pay interest on these accounts." (Appendix A, p. 9a; 390 F. Supp. at 1361)

In so holding, the court below misapplied the decisions of this Court construing the Contract Clause.

The court below did not discuss the Contract Clause in detail. It merely stated its conclusion as to the existence of police power quoted above, and cited in

support of that conclusion four decisions of this Court: *Home Building & Loan Ass'n. v. Blaisdell, supra; Gelfert v. National City Bank*, 313 U.S. 221 (1941); *East New York Savings Bank v. Hahn*, 326 U.S. 230 (1945); and *El Paso v. Simmons, supra*. However, those four decisions do not support the conclusion.

This Court's decisions in *Blaisdell, Gelfert*, and *Hahn* all dealt with state efforts to mitigate the disastrous effects of the great depression on real estate financing arrangements. In *Blaisdell*, the Court sustained a Minnesota law, enacted in response to crisis, that extended the period of redemption for mortgagors. Writing for the Court, Chief Justice Hughes undertook a comprehensive review of the Court's interpretation of the Contract Clause. The key point made by the Chief Justice was that there is inherent in every contract the power of the state to alter that contract when the public order or a vital public interest is involved. The police power, he said, is not abrogated merely because its proper exercise may result in the impairment of existing private contractual obligations. A law may pass constitutional muster even though it alters contractual obligations if it meets a two-pronged test: (1) it is protective of the public order or a vital public interest, and (2) it is a reasonable response to the need for such protection.

The court below applied neither prong of this test. It did not and could not find any involvement of the public order or a vital public interest, and it therefore could not reach any issue as to a reasonable response to the need for protection thereof. The importance of findings with respect to protection of the public order or a vital public interest to justify an impairment of

contract was emphasized by Chief Justice Hughes in *W.B. Worthen Co. v. Thomas*, 292 U.S. 426 (1934), where, in holding a statute impairing a mortgage contract unconstitutional, he referred to *Blaisdell* as follows (292 U.S. at 433):

> "We said that the constitutional prohibition should not be so construed as to prevent limited and temporary interpositions with respect to the enforcement of contracts if made *necessary by a great public calamity such as fire, flood or earthquake, and that the State's protective power could not be said to be non-existent when the urgent public need demanding relief was produced by other and economic causes.* But we also held that this essential reserved power of the State must be construed in harmony with the fair intent of the constitutional limitation, and that this principle precluded a construction which would permit the State to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them." (emphasis supplied).

Blaisdell can in no way stand as precedent for the decision of the court below. *Gelfert* and *Hahn*, like *Blaisdell*, involved mortgage foreclosure legislation enacted in response to the great depression, and in these cases the Court, in applying the *Blaisdell* test, had no difficulty in finding a threat to the public order and reasonableness of the steps taken to meet the threat.

In *El Paso*, the most recent case decided by this Court under the Contract Clause, Mr. Justice White, writing for the majority, found a vital public interest in need of protection and found reasonable the protective

steps adopted by the state. The evil addressed by the legislation at issue in *El Paso* was a perpetual right of redemption attaching to land that had been sold by the state. This perpetual right of redemption had resulted in chaos in land titles in the state, with owners subject to assertion by unknown parties of rights of redemption granted decades earlier. The vital public interest thus was clear; and conversion of perpetual rights of redemption into rights exercisable within a certain period of time was a reasonable protective response.

Thus, the four cases cited by the court below all applied an appropriate exception to the Contract Clause, and did not eliminate the clause from constitutional jurisprudence. If the decision of the court below is permitted to stand, the Contract Clause, and the protection it was intended to afford citizens by preserving the integrity of their private contracts, would be in serious jeopardy. It is thus of considerable importance to our constitutional structure for this court to review and reverse that decision.

CONCLUSION

Probable jurisdiction should be noted and the case set for full briefing and argument.

Respectfully submitted,

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APPENDIX

APPENDIX A

OPINION BELOW

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

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JAMAICA SAVINGS BANK,
Plaintiff,

v.

LOUIS J. LEFKOWITZ, as Attorney General of the State of New York,

Defendant.

: 74-C-1066

OPINION

: March 3 1975

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THREE-JUDGE COURT:

Hon. Murray I. Gurfein,
Circuit Judge

Hon. Mark A. Costantino,
District Judge, E.D.N.Y

Hon. Whitman Knapp,*
District Judge, S.D.N.Y.

*When the case was argued, Judge Anthony J. Travia, U.S.D.J., E.D.N.Y., was on the panel. He resigned before a decision could be rendered, and by order Judge Knapp was substituted for him and participated in the decision.

APPEARANCES:

BOND, TOBIN & DAVIS, Attorneys for Plaintiff, 25 Roslyn Road, Mineola, New York, HUGHES HUBBARD & REED, of Counsel, One Wall Street, New York, New York

LOUIS J. LEFKOWITZ, Attorney General of the State of New York, Attorney for Defendant, Two World Trade Center, New York, New York, by STANLEY L. KANTOR, Assistant Attorney General

COSTANTINO, District Judge

This suit attacks the constitutionality of the recently enacted New York Statute, Chapter 119 of the Laws of 1974,[1] which requires mortgage lending institutions to

[1] The pertinent parts of Chapter 119 are:

Section 1. The Banking law is hereby amended by adding thereto a new section, to be section fourteen-b, to read as follows:

§ 14.b. **Power of the banking board to prescribe minimum rate of interest on mortgage escrow accounts**

1. The banking board shall have the power to prescribe, from time to time but not more often than once in every three month period, by a three-fifths vote of all its members, by regulation a minimum rate of and method or basis of computing, interest that a mortgage investing institution shall be required to pay on each escrow account maintained with respect to a mortgage on a one to six family residence occupied by the owner and located in this state, which rate shall be greater than the rate of interest

pay interest on mortgage "escrow" accounts. The complaint requests the convening of a three-judge court

required to be paid under section 5-601 of the general obligations law.

* * *

4. In no event shall interest be required to be paid on escrow accounts where (i) there is a contract between the mortgagor and the mortgage investing institution, entered into before the date this sub-division shall have become a law which contains an express disclaimer of an obligation on the part of the mortgage investing institution to pay interest on such accounts, or (ii) the payment of such interest would violate any federal law or regulation, or (iii) such accounts are maintained with a mortgage servicing company, neither affiliated with nor owned in whole or in part by the mortgage investing institution, under a written contract, entered into before the date this subdivision shall have become a law, which contract does not permit the mortgage investing institution to earn or receive a return from the investment of such accounts.

Section 2. Article five of the general obligations law is hereby amended by inserting therein a new title, to be title six, to read as follows:

TITLE 6. INTEREST ON CERTAIN DEPOSITS

§ 5-601. **Interests on deposits in escrow with mortgage investing institutions**

Any mortgage investing institution which maintains an escrow account pursuant to any agreement executed in connection with a mortgage on any one to six family residence occupied by the owner and located in this state shall, for each quarterly period in which such escrow account is established, credit the same with dividends or interest at a rate of not less than two per centum per year based on the average of the sums so paid for the average length of time on deposit or a rate prescribed by the banking board pursuant to section fourteen-b of the banking law and pursuant to the terms and conditions set forth in that section whichever is higher. The banking board shall prescribe by

pursuant to 28 U.S.C. §§2281 and 2284, preliminary and permanent injunctive relief enjoining enforcement of Chapter 119, and a declaratory judgment that the section is unconstitutional as applied. Defendant has cross moved to dismiss the complaint for lack of federal jurisdiciton, failure to state a claim for which relief can be granted and failure to join indispensable parties. Specifically plaintiff argues that the statute contravenes the contracts clause of the Constitution, art. I, section 10, and the equal protection and due process clauses of the Fourteenth Amendment. The action is brought under the aforementioned sections of the Constitution, 42 U.S.C. §1983, 28 U.S.C. §§2201 and 2202 and jurisdiction is founded upon 28 U.S.C. §§1331 and 1343 (3). By order dated August 29, 1974 plaintiff's application to convene a three-judge court was granted.

I

The facts have been stipulated to and those relevant to this decision can be briefly stated. It is the general practice of the mortgage lending industry to require that a borrower to whom a mortgage loan has been extended deposit with the lending institution funds to ensure payment of real estate taxes and assessments,

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regulation the method or basis of computing any minimum rate of interest required by this section and any such minimum rate shall be a net rate over and above any service charge that may be imposed by any mortgage lending institution for maintaining an escrow account. No mortgage investing institution shall impose a service charge in connection with the maintenance of an escrow account unless provision therefor was expressly made in a loan contract executed prior to the effective date of this act.

and insurance premiums on the mortgaged premises. These deposits, called "escrow" accounts, protect the lending institution from being subjected to the superior claims of taxing authorities if there is a failure to pay taxes and a loss from destruction of the mortgaged property if insurance policies lapse.

When plaintiff entered into the mortgage contracts at issue it did not intend to segregate these deposits or account to mortgagors for profits arising from the use of the escrow funds. The contract provisions establishing the escrow accounts, however, did not refer to the disposition of any income from the accounts nor did they indicate any intention of the parties as to who shall have use of the funds in the accounts between the day of deposit and the due date of the taxes and insurance premiums. Paragraph 12 of the stipulation of facts is important to the disposition of this suit and accordingly will be included verbatim:

> At all times when the 12,000 mortgage loans referred to in Paragraph 4 above were made, it was JSB's [plaintiff's] policy to commingle escrow accounts with other funds of JSB and not to pay any specific return on the escrow accounts to the mortgagors. This policy was made known to anyone who inquired as to what the policy of JSB was in this regard. It was well known to all experienced real estate attorneys and certainly to attorneys representing mortgagors in their dealings with JSB. With relatively rare exception, all of the 12,000 mortgagors referred to above were represented in loans by counsel of their own choosing; and most of the exceptions were themselves attorneys. Any mortgagor or potential mortgagor who has inquired as to whether he might earn a return on the escrow account has been informed

that no such return is available. If any such return had been insisted upon, it would have been the policy of JSB to refuse to make the loan.

Chapter 119 requires the plaintiff and other mortgage lending institutions to pay homeowner mortgagors a minimum of two percent interest on escrow funds deposited with the mortgagee for the future payment of taxes and insurance premiums, except where the mortgages were executed before the enactment and expressly provide that no interest is to be paid.

II

Plaintiff first contends that chapter 119 "impaired" the mortgage contracts entered into prior to April 1, 1974 – the date of enactment – since under then-existing law it had no obligation to pay interest. In determining if there has been an impairment the initial inquiry must be whether there is in fact a contract as to the use of the escrow funds. Plaintiff argues in essence that non-payment of interest on the escrow accounts became an unstated term of the mortgage contracts because of the knowledge of the attorneys for mortgagors that the bank would pay no interest and the attorneys' acquiescence in that arrangement. Further, the bank contends that non-payment of interest was a "bargained for" term, citing as proof its assertion that it would not have entered into any mortgage arrangement had it been required to pay interest on the escrow accounts. The bank maintains that the knowledge of mortgagors' attorneys of the policy of no interest "show[s] that the use of the escrow funds was

bargained for by Jamaica Savings Bank in a legal sense even if in particular instances the question may have not been raised by the mortgagors."

This assertion necessarily leads the court to consider whether non-payment of interest became an "implied in fact" term of the mortgage contracts. Like express terms, implied in fact terms must be agreed to become part of the contract, 1 Williston, Contracts §3; *Crosby v. Paul Hardeman, Inc.*, 414 F.2d 1, 7 (8th Cir. 1969). Basic contract law teaches that each party must agree with definiteness to the terms of a contract and manifest its intention to create an obligation to the other party. Simpson, Contracts, §§3, 9 (1954). Even when contracts do not so expressly state it is sometimes possible to infer that certain unstated terms are part of the contract because of the circumstances. *Baltimore & Ohio R.R. v. United States*, 261 U.S. 592, 598 (1923). The New York Court of Appeals many years ago stated the rule most cogently:

> A contract cannot be implied *in fact* * * * against the intention or understanding of the parties; * * * The assent of the person to be charged is necessary and unless he has conducted himself in such a manner that his assent may fairly be inferred he has no contract.

Miller v. Schloss, 218 N.Y. 400, 406-07 (1916). *See also Gray v. Kaufman Dairy & I.C. Co.*, 162 N.Y. 388, 397 (1900).

In the case under consideration the persons "to be charged" are the mortgagors. Therefore, it is necessary to prove that they agreed that no interest would be received. The only proof offered here as to the assent of the mortgagors is that their attorneys may have known of the bank's policy. How this indicates a

"bargained for" term that has been agreed to is not explained by the bank. The absence of a provision in a series of contracts providing that no interest will be paid on escrow accounts cannot raise the implication that non-payment of interest became a term of the contracts. Since there were no provisions in the contracts as to the use and disposition of the profits derived from use of the escrow accounts, legislation which provides for a specific allocation of those profits cannot be said to impair the contracts.

The plaintiff implies alternatively that, even without an express provision to that effect in the mortgage, under New York law interest is not payable on escrow funds. If New York law were clearly to that effect it might be an implied negative term of the mortgage agreement that conceivably could raise a question under the obligation of contracts clause. The cases cited by plaintiff fall short, however, of establishing such a principle of New York law. *New York State Thruway Authority v. Hurd*, 25 N.Y.2d 150 (1960) is cited in support of the proposition. In *Hurd* the Court of Appeals decided that in the absence of an express obligation, the Thruway Authority was not required to pay interest to the State of New York for advances made to it by the State. In that case there were advances to the obligee. Here there is a deposit of money to be paid to a third party. In *Hurd* the considerations were quite different involving the power to make advances of public money to a public authority. In that situation, the Court of Appeals reasonably suggested that an implied obligation to pay interest may not lightly be found. 25 N.Y.2d at 158.

Lower court cases cited are in some disagreement and we do not find them sufficiently definitive to require

the incorporation of any legal doctrine as an implied term of the contract.

We need not go so far as the Supreme Judicial Court of Massachusetts in determining that escrow accounts deposited in banks to pay taxing authorities are trusts. *Carpenter v. Suffolk Franklin Savings Bank*, _____ Mass. _____, 291 N.E.2d 609 (1973). It is enough for us to say that New York law falls short of declaring as a term of the mortgage, that interest need not be paid on such funds.

Even if the unstated "no interest" terms were, in fact, bargained for by the mortgagors or, alternatively, even if New York State law was clear that there was no obligation to pay interest on escrow accounts, the state legislature would have had the right under its police power to require that mortgage lending institutions pay interest on these accounts. *Home Building & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934); *Gelfert v. National City Bank*, 313 U.S. 221 (1941); *East New York Savings Bank v. Hahn*, 326 U.S. 230 (1945); *El Paso v. Simmons*, 379 U.S. 479 (1965).

> The Blaisdell opinion, which amounted to a comprehensive restatement of the principles underlying the application of the Contract Clause, makes it quite clear that "[n]ot only is the constitutional provision qualified by the measure of control which the State retains over remedial processes, but the State also continues to possess authority to safeguard the vital interests of its people. It does not matter that legislation appropriate to that end 'has the result of modifying or abrogating contracts already in effect.' *Stephenson v. Binford*, 287 U.S. 251, 276. Not only are existing laws read into contracts in order to fix obligations as between the parties, but the reservation of

> essential attributes of sovereign power is also read into contracts as a postulate of the legal order. . . . " 290 U.S. at 434-435. Moreover, the "economic interests of the State may justify the exercise of its continuing and dominant protective power notwithstanding interference with contracts." *Id.*, at 437. The State has the "sovereign right . . . to protect the . . . general welfare of the people. . . . Once we are in this domain of the reserve power of a State we must respect the 'wide discretion on the part of the legislature in determining what is and what is not necessary.' " *East New York Savings Bank v. Hahn*, 326 U.S. 230, 232-233.

El Paso v. Simmons, 379 U.S. 497, 508-509 (1965).

What occurred in this case was that the state legislature created a remedy to a problem it perceived – the inability of citizens seeking mortgages from mortgage lending institutions to bargain effectively for the use of funds put into the hands of the institutions to secure the mortgaged premises. It is uncontroverted that mortgagors could not have obtained mortgages if they had insisted upon a term in the contracts providing interest. These mortgage agreements – almost all identical – were drafted by the plaintiff and essentially were offered to potential mortgagors on a take it or leave it basis. The state legislature properly exercised its power to correct an imbalance in the bargaining relationship.

For the reasons stated, Chapter 119 did not unconstitutionally impair the mortgage contracts under consideration.

III

Plaintiff next asserts that the statutory distinction between contracts which expressly exclude the payment of interest and those which are silent on the subject is irrational and thus violative of the equal protection clause of the Fourteenth Amendment. The test for determining whether a statutory classification violates the equal protection clause is whether the classification is made without any reasonable basis and therefore is purely arbitrary. *Royster v. McGinnis*, 410 U.S. 263 (1973); *McGowan v. Maryland*, 366 U.S. 420 (1961); *Morey v. Dowd*, 354 U.S. 457 (1957).

The distinction in the statute implicitly recognizes that mortgagors may have entered into the mortgage contracts never having considered the possibility of interest on the escrow accounts. However, where, by express language, mortgagors were made aware of the possibility of interest, and they expressly waived their rights to it, then the legislature was entirely rational in not wishing to confront a potential constitutional problem. Moreover, the purpose of the statute – to correct the imbalance in the bargaining relationship between banks and homeowners – would not necessarily be served by modifying contracts which contained expressed "bargained for" terms. Since the distinction has a reasonable basis, *i.e.*, avoiding a possible constitutional attack and restoring fairness to the relationship between banks and mortgagors, there is no violation of the equal protection clause.

IV

Plaintiff's final contention is that the Chapter 119 requirement that it pay interest on escrow funds is a "taking" without due process in violation of the Fourteenth Amendment. This claim is not substantial. It is not necessary to determine with precision what legal relationship was created by the escrow deposit. Mortgagees are constitutionally entitled to no more than payment in full. *Gelfert v. National City Bank*, 313 U.S. 221, 233 (1941). Whether it was a trust or an agency or whether the bank actually became a debtor to the mortgagor is uninportant for constitutional purposes, since, in any event, the mortgage institution did not obtain an ultimate beneficial interest in the funds for itself. Indeed, if the escrow accounts were true bank deposits we see no reason why the state could not require the payment of interest on such accounts for the benefit of a class that needed protection.

If the plaintiff had obtained a beneficial interest, perhaps that interest could only be divested under the police power. *See Home Bldg. & L. Ass'n v. Blaisdell*, 290 U.S. 398, 435-38 (1934); *East New York Savings Bank v. Hahn*, 326 U.S. 230, 231-32 (1945). Since the funds were given to the bank for the specific purpose of paying a third party, either the taxing authority or the insurance company, the money was never intended to belong to the mortgage institution for its benefit. It is true that creditors of the mortgagor could not reach the funds. *See Matter of Simon*, 167 F. Supp. 214 (E.D.N.Y. 1958); *Central Suffolk Hospital Ass'n v. Downs*, 213 N.Y.S.2d 192 (Sup. Ct. Kings Co., 1961); and *Valerio v. College Point Savings Bank*, 48 Misc. 2d

91 (Sup. Ct. Suffolk Co., 1965). But that is not because the bank had the beneficial interest in the funds. It is rather because the mortgagor had already divested himself of the funds for payment to the third party through the agency of the bank and could no longer recall them. Since the bank had no ultimate beneficial interest, there is no need to consider the effect of the police power of the state upon these escrow accounts for the protection of homeowners. *See Home Bldg. & L. Ass'n v. Blaisdell, supra.*

Plaintiff might also have been able to argue that the Chapter 119 requirement is a taking if it could prove that to pay the interest to mortgagors it would have to dip into its own general funds if the profits from the escrow accounts could not cover the required payments. It was the intention of the New York State Legislature in adopting Chapter 119 to require that mortgage lending institutions share with their mortgagors the profits which are realized from the investment of monies held by the institutions. After considerable investigation including public hearings, the legislature concluded that mortgage lenders could "well afford to pay" at least two percent interest on escrow accounts, Memorandum in support of the Bill, Chapter 119, §2268, 1974. Plaintiff offers no evidence to rebut this finding. The fact that the plaintiff might currently be losing money on its mortgage loans as a whole sheds no light on the escrow account problem. We are concerned only with the profits and losses realized specifically from the investment of escrow funds. We find that no such showing has been made.

In view of the above analysis it appears that plaintiff's claim of an unconstitutional taking is without merit.

Conclusion

For the above stated reasons plaintiff's application for declaratory relief that Chapter 119 is unconstitutional and an injunction enjoining enforcement of that provision is hereby denied. Defendant's cross motion to dismiss the complaint is granted.

The Clerk of the court is directed to prepare an order directing that this complaint be dismissed.

/s/ Murray Gurfein C.J.
/s/ Mark A. Costantino D.J.
/s/ Whitman Knapp D.J.

KNAPP, District Judge, concurring

I concur completely in the majority opinion except insofar as it suggests – in the opening paragraphs of Part II – that there is "no contract" with respect to the payment or non-payment of interest for the use of the escrow funds. Believing that the mortgage contracts between the homeowners and the banks necessarily comprehend the entire understanding between the parties – which must include the payment or non-payment of interest – I concur on the alternative ground set forth at the end of Part II.

/s/Whitman Knapp D.J.

APPENDIX B

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

JAMAICA SAVINGS BANK,
Plaintiff,

v.

LOUIS J. LEFKOWITZ, as Attorney General of the State of New York,
Defendant.

JUDGMENT
74-C-1066

JUDGMENT

An opinion of the Honorable Murray I. Gurfein, United States Circuit Judge, the Honorable Mark A. Costantino, United States District Judge, and the Honorable Whitman Knapp, United States District Judge, having been filed on March 3, 1975, denying the plaintiff's application for declaratory relief that Chapter 119 is unconstitutional and for an injunction enjoining enforcement of that provision, and granting the defendant's cross motion to dismiss the complaint and directing the Clerk to dismiss the complaint, it is

ORDERED and ADJUDGED that the plaintiff take nothing of the defendant and that the complaint is dismissed.

Dated: Brooklyn, New York
March 6, 1975

/s/
Clerk

FILED
IN CLERK'S OFFICE
U.S. DISTRICT COURT E.D. N.Y.
MAR 6 1975

APPENDIX C

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

JAMAICA SAVINGS BANK,
Plaintiff,
-against-

LOUIS J. LEFKOWITZ, as Attorney General of the State of New York,
Defendant.

74-C-1066 (M.A.C.)

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Jamaica Savings Bank, the plaintiff above named, hereby appeals to the Supreme Court of the United States from the final judgment dismissing the complaint entered in this action on March 6, 1975.

This appeal is taken pursuant to 28 U.S.C. §1253.

Dated: May 2, 1975

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APPENDIX D

CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

1. Article I, Section 10 (the "Contract Clause") of the United States Constitution provides in pertinent part:

> Section 10. No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . . .

2. Chapter 119 of the 1974 Laws of the State of New York provide:

AN ACT

To amend the banking law and the general obligations law, in relation to requiring the payment of interest on certain escrow accounts and the power of the banking board to prescribe the rate thereof; the general obligations law, banking law and real property law, in relation to the imposition of prepayment penalties on mortgages of real property improved by a one to six family owner occupied residence and on cooperative apartment loans; and the real property law in relation to late payments on such mortgage and loans

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

EXPLANATION – Matter in *italics* is new; matter in brackets [ ] is old law to be omitted.

Section 1. The banking law is hereby amended by adding thereto a new section, to be section fourteen-b, to read as follows:

§14-b. Power of the banking board to prescribe minimum rate of interest on mortgage escrow accounts. 1. The banking board shall have the power to prescribe, from time to time but not more often than once in every three month period, by a three-fifths vote of all its members, by regulation a minimum role of, and method or basis of computing, interest that a mortgage investing institution shall be required to pay on each escrow account maintained with respect to a mortgage on a one to six family residence occupied by the owner and located in this state, which rate shall be greater than the rate of interest required to be paid under section 5–601 of the general obligations law.

2. In making such determination the banking board shall consider pertinent economic and cost factors including, but not limited to: (i) current yields on short term investments, (ii) current dividend rates paid on regular savings accounts throughout this state, (iii) currently prevailing interest rates on conventional and insured or guaranteed mortgage loans in this state, (iv) cost factors in maintaining escrow accounts and (v) such other pertinent economic or cost factors that the banking board shall deem to be appropriate. Prior to the banking board's prescription of any such minimum rate of interest, the superintendent shall make a written recommendation to the banking board as to such minimum rate of interest, reciting the economic and cost data and criteria upon which such recommendation is based. Prior to making such recommendation, the superintendent may invite presentation, by interested

persons, of information and data relating to economic and cost factors relevant to such minimum rate of interest.

3. The banking board may promulgate such regulations as it deems necessary and proper to implement and define the provisions of this section. The banking board may prescribe the minimum rate of interest from time to time, but not more often than once in any three-month period, and shall provide reasonable notice to the public of any change in the rate of interest, of the effective date of such change, which shall be not less than seven days following the adoption of such change by the banking board, and of any rule or regulation adopted pursuant to this subdivision.

4. In no event shall interest be required to be paid on escrow accounts where (i) there is a contract between the mortgagor and the mortgage investing institution, entered into before the date this subdivision shall have become a law which contains an express disclaimer of an obligation on the part of the mortgage investing institution to pay interest on such accounts, or (ii) the payment of such interest would violate any federal law or regulation, or (iii) such accounts are maintained with a mortgage servicing company, neither affiliated with nor owned in whole or in part by the mortgage investing institution, under a written contract, entered into before the date this subdivision shall have become a law, which contract does not permit the mortgage investing institution to earn or receive a return from the investment of such accounts.

5. "Mortgage investing institution" as used in this section and in section 5–601 of the general obligations law shall mean and include any bank, trust company,

national bank, savings bank, savings and loan association, federal savings and loan association, private banker, credit union, investment company, insurance company, pension fund, mortgage company or other entity which makes, extends or holds a mortgage on any one to six family residence occupied by the owner and located in this state.

6. "Escrow account" as used in this section and in section 5–601 of the general obligations law shall mean any account established pursuant to an agreement between a mortgagor and a mortgage investing institution whereby the mortgagor pays to the mortgage investing institution or his designee amounts to be used for the payment of real estate taxes, school taxes, insurance premiums, water rents or any similar charges.

7. "One to six family residence" as used in this section and in section 5–601 of the general obligations law shall mean property used primarily for residential purposes for one to six families, including property held in condominium form, and which is occupied in whole or in part by the owner.

8. If any provision of this section, or the application of such provision to any individual, company, corporation or circumstance, shall be held invalid, the remainder of this section, and the application of such section to individuals, companies, corporations, or circumstances other than those to which it is held invalid, shall not be affected thereby.

§2. Article five of the general obligations law is hereby amended by inserting therein a new title, to be title six, to read as follows:

TITLE 6

INTEREST ON CERTAIN DEPOSITS

Section 5–601. Interest on deposits in escrow with mortgage investing institutions.

§5–601. Interest on deposits in escrow with mortgage investing institutions. Any mortgage investing institution which maintains an escrow account pursuant to any agreement executed in connection with a mortgage on any one to six family residence occupied by the owner and located in this state shall, for each quarterly period in which such escrow account is established, credit the same with dividends or interest at a rate of not less than two per centum per year based on the average of the sums so paid for the average length of time on deposit or a rate prescribed by the banking board pursuant to section fourteen-b of the banking law and pursuant to the terms and conditions set forth in that section whichever is higher. The banking board shall prescribe by regulation the method or basis of computing any minimum rate of interest required by this section and any such minimum rate shall be a net rate over and above any service charge that may be imposed by any mortgage lending institution for maintaining an escrow account. No mortgage investing institution shall impose a service charge in connection with the maintenance of an escrow account unless provision therefor was expressly made in a loan contract executed prior to the effective date of this act.

§3. Subdivision three of section 5–501 of such law, as added by chapter three hundred forty-nine of the

laws of nineteen hundred sixty-eight, is hereby amended to read as follows:

3. If a rate of interest has been prescribed by the banking board pursuant to section fourteen-a of the banking law and the rate of interest charged, taken or received on any loan or forbearance secured primarily by *either (i)* an interest in real property improved by a one [or two] *to six* family residence occupied by the owner *or (ii) certificates of stock or other evidence of an ownership interest in a corporation or partnership formed for the purpose of the cooperative ownership of real estate taken as security for a loan under subdivision five of section one hundred three of the banking law, subdivision eight-a of section two hundred thirty-five of such law or subdivision two-a of section three hundred eighty of such law,* exceeds six per centum per annum,

a. *in the case of a loan referred to by clause (i) of this subdivision,* the term of such loan or forbearance may extend five years beyond the maximum maturity of such loan otherwise prescribed by law, and

b. notwithstanding any other provision of law, the unpaid balance of the loan or forbearance may be prepaid, in whole or in part, [without penalty] *at any time. If prepayment is made* on or after [three years] *one year* from the date the loan or forbearance is made, [and such] *no penalty may be imposed. If prepayment is made prior to such time, no penalty may be imposed unless provision therefor is expressly made in the loan contract. In all cases, the* right of prepayment shall be stated in the instrument evidencing the loan or forbearance, provided, however, that the provisions of this subdivision shall not apply to the extent such provisions are inconsistent with any federal law or regulation.

§4. Subdivision two of section three hundred ninety-three of the banking law, as amended by chapter one thousand forty-one of the laws of nineteen hundred seventy-one, is hereby amended to read as follows:

2. Any mortgage loan made by a savings and loan association to a member may be repaid in whole or in part at any time, but the loan contract may expressly provide for a period during which prepayment may not be made without incurring prepayment penalties. When such provision is contained therein, the loan contract must also expressly provide for prepayment penalties or no prepayment penalties may be collected when the loan is prepaid. However, where a loan is secured by mortgage on a *one to six family* residence [containing fewer than four housing units], *or is extended to finance the purchase of a cooperative under subdivision two-a of section three hundred eighty of this chapter* which residence *or cooperative* is or will be occupied in whole or in part by the member, prepayment penalties *may be imposed only during the first twleve [sic] months from the date the mortgage or cooperative loan was made and* may not exceed:

(a) Interest for a period of three months on the principal so prepaid; or

(b) Interest [and premium for the whole] *for the remaining months of the first* year on the principal so prepaid if the prepayment is made at any time within one year from the date the loan is made.

The book value of instalment shares pledged as security for any such loan shall be deducted from the amount of the loan in determining the amount of principal upon which such interest [or premium] may be charged.

§5. Section two hundred fifty-four-a of the real property law, as added by chapter four hundred twenty-one of the laws of nineteen hundred seventy-two, is hereby amended to read as follows:

§254-a. Right of election of mortgagee in certain cases. If a bond or note, or the mortgage on real property, improved by a one [or two] *to six* family residence occupied by the owner, securing the payment of same, contains (1) a provision whereby the mortgagee retains the right to accelerate the due date for payment of the balance of principal upon a transfer or sale of such real property or by alienation of title of such real property due to an act or operation of law, and (2) a provision for payment of any charge, however denominated, in the nature of a prepayment fee and if a mortgagor sells or transfers his property or if title to the mortgaged property is transferred by act or operation of law and the *purchaser requests permission to assume the mortgage or take the mortgaged premises subject to the mortgage, but the* mortgagee does not consent to [the proposed or actual transfer] *such request* and thereby necessitates prepayment of the mortgage, the mortgagee shall not levy a prepayment fee; provided, however, that the provisions of this section shall not apply to the extent such provisions are inconsistent with any federal law or regulation.

§6. Such law is hereby amended by inserting therein a new section, to be section two hundred fifty-four-b, to read as follows:

§254-b. Limitation on late charges. 1. If a bond or note, or the mortgage on real property, heretofore or hereafter made, improved by a one to six family residence occupied by the owner, securing the payment

of same, or a note representing a loan for the purpose of financing the purchase of an ownership interest in, and proprietary lease from, a corporation or partnership formed for the purpose of the cooperative ownership of residential real estate, contains a provision whereby the mortgagee or lender retains the right to collect a late charge on any instalment which has become due and remains unpaid, such charge on any such delinquent instalment, regardless of the period it remains in default, shall not exceed and shall only be enforced to the extent of two percent of such delinquent instalment; provided, however, that no charge shall be imposed on any instalment paid within fifteen days after the due date. No such late charge shall be deducted from any regular instalment payment by the mortgagor or borrower, but shall be separately charged and collected by the mortgagee or lender. In the absence of a specific provision in a bond, note or mortgage no late charge on any delinquent instalment shall be assessed or collected. The term "instalment" shall include amounts representing interest, amortization of principal and payments in respect of insurance premiums, taxes and utility charges if the bond, note or mortgage provides for collection thereof by the mortgagee.

2. The provisions in this section shall not apply to any loan or forbearance insured by the federal housing commissioner or for which a commitment to insure has been made by the federal housing commissioner or to any loan or forbearance insured or guaranteed pursuant to the provisions of an act of congress entitled "Servicemen's Readjustment Act of 1944", or to the extent the provisions of this section are inconsistent with any other federal law or regulation.

3. If any provision of this section, or the application of such provision to any individual, company, corporation, or circumstance, shall be held invalid, the remainder of this section, and the application of such section to individuals, companies, corporations, or circumstances other than those to which it is held invalid, shall not be affected thereby.

§ 7. This act shall take effect immediately, provided however, that sections one and two of this act shall not take effect until the first day of July next succeeding the date on which this act shall have become a law, provided further, that subdivision four of section fourteen-b of the banking law as added by section one of this act shall take effect immediately, and provided further, that the provisions of sections three and four of this act shall only apply to mortgages, or loans for the purpose of financing the purchase of or refinancing an existing ownership interest in certificates of stock or other evidence of an ownership interest in, and a proprietary lease from, a corporation or partnership for the purpose of the cooperative ownership of real estate, entered into on or after the date of enactment.